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RUEHLO/AMEMBASSY LONDON 4196
RUEHKB/AMEMBASSY BAKU 0011
RUEHKP/AMCONSUL KARACHI 2263
RUEHCG/AMCONSUL CHENNAI 8197
RUEHDE/AMCONSUL DUBAI 0134
RUCPDOC/DEPT OF COMMERCE WASHDC
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COMMERCE FOR JONATHAN STONE

E.O. 12958: N/A
TAGS: EINV ENRG PREL CE IR
SUBJECT: SRI LANKA: IRAN REFINERY OFFER COMPLICATES PICTURE FOR US
BIDDERS; EMBASSY CONTINUES ADVOCACY

REF: A. COLOMBO 1050 B. COLOMBO 1639 C. 2006 COLOMBO 2086

¶1. (SBU) Summary: Iran's recent promise to finance a $750 million expansion of Sri Lanka's sole oil refinery complicates the ambitions of U.S. firms Global Energy and ENGlobal to secure contracts for similar refinery investments. The head of the state-owned Ceylon Petroleum Corporation doubts Iran's offer will pan out, however. He and others told us Iran only reluctantly agreed to this deliverable during President Rajapaksa's recent visit and was unwilling to commit to specifics. The Iran offer follows similar expressions of interest by other Middle Eastern countries in building a refinery in Sri Lanka, none of which have progressed. Post is therefore continuing its ongoing advocacy for Global Energy's bid to build, own, operate, and transfer the refinery expansion. Post is also staying in close contact with ENGlobal, which won a tender (but has not yet received a contract) to conduct a feasibility study for Ceylon Petroleum to do the refinery expansion itself. End summary.

GLOBAL ENERGY'S REFINERY WOULD JOIN EXISTING PLANT
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¶2. (SBU) Sri Lanka's sole oil refinery, at Sapugaskunda outside Colombo, is owned and operated by the state-owned Ceylon Petroleum Corporation (CPC). The refinery, built in 1969, can process about 50,000 barrels of oil per day to produce gasoline, diesel, and jet fuel. However, it can only refine light sweet crude because its non-pressurized ship-to-shore transfer pipeline cannot handle heavier forms of crude. When the refinery was built, light sweet crude was widely available, but currently Iran is one of only a few suppliers; for this reason, Sri Lanka purchases about 70% of its crude supply from Iran. Another liability of the old technology in the existing facility is its high sulfur emissions -- ten times higher than the internationally recommended level which Sri Lanka has committed to meet.

¶3. (SBU) The CPC plans to double Sapugaskunda production capacity to 100,000 barrels per day, which would satisfy Sri Lanka's entire near-term demand for refined petroleum products. It envisions doing this by building a twin of the existing refinery, using similar technology and sharing much of the existing infrastructure at

Sapugaskunda. The CPC would like an expansion project also to include a long-overdue renovation and upgrade of the existing facilities to make them cleaner and more efficient. This is exactly what U.S. firm Global Energy and Industrial Operations, Inc., (Global Energy) has proposed to do on a build, own, operate, and transfer (BOOT) basis valued at $800 million (ref A).

CEYLON PETROLEUM CORP WANTS TO GO IT ALONE;
CHOSE ENGLOBAL FOR FEASIBILITY STUDY

¶4. (SBU) However, because refining is one of the few activities that any Sri Lankan state-owned entity has ever been able to do profitably, the CPC prefers to do the expansion ad upgrade itself, rather than bringing in a foregn investor. As an initial step toward this, inJuly the CPC tendered for an outside company to conduct a feasibility study on the refinery upgrade and expansion. In early September, U.S. company ENGlobal won the bidding for this work, and expected to have a signed contract by the middle of the month.

¶5. (SBU) Advocacy note: In 2006, both Global Energy and ENGlobal sought USG advocacy for their efforts to construct the Sapugaskunda refinery upgrade and expansion. In September 2006, the Department of Commerce Advocacy Center judged, on national interest grounds, that USG advocacy should be for the Global Energy bid. Since then, Embassy Colombo has advocated solely for Global Energy in discussions involving Sri Lanka's plans to commission new refinery construction. In discussions involving the feasibility study for the proposed project, Embassy has told the GSL that it welcomed the selection of ENGlobal for the work. We have maintained this

distinction in light of the separate scopes of work being considered and in the view that a U.S.-led feasibility study would ultimately benefit Global Energy's bid for a BOOT contract. We are confident this distinction has been clear to Sri Lankan officials. End advocacy note.

IRAN OFFER LEAVES ENGLOBAL CONTRACT HANGING,
GLOBAL ENERGY WAITING FOR IT TO FALL THROUGH

¶6. (SBU) Both Global Energy's proposed BOOT project and ENGlobal's contract for the feasibility study for the CPC-led project have been set back by Iran's November offer to finance both the refinery expansion and feasibility study (ref B). Although neither the Minister of Petroleum Resources nor the chairman of the Ceylon Petroleum Corp thinks Iran will actually deliver on its offer, they are deferring their preferred plan for a CPC-led project while waiting to see if Iran's offer is serious. CPC Chairman Asantha de Mel told Econoff that he would prefer to have ENGlobal conduct the feasibility study, because he recognized the conflict of interest in Iran doing both the study and the project. He implied, however, that he was under pressure from the Finance Ministry to go along with the Iran study because it would be free; and with the Iran financing for the overall project, if it materializes, because it would ostensibly be cheaper than private sector financing. (He noted that Iran had sought to place a value of $1.2 billion on the proposed refinery expansion, which Sri Lanka had resisted.)

SIMILAR OFFERS HAVE ALL COME TO NAUGHT

¶7. (SBU) Iran's offer is not the first of its kind. Previous presidential and ministerial visits to Middle Eastern countries in 2007 generated similar offers or expressions of interest. In April, Sri Lanka asked Saudi Arabia for a $500 million loan to finance the refinery expansion. Also in April, Petroleum Minister Fowzie reported that Egypt would conduct the feasibility study for free. In May, Kuwait officials made a similar promise to visiting President Rajapaska. None of these are actually being pursued.

¶8. (SBU) There also have been multiple reports of possible private refinery investments in other parts of the country. These have focused mainly on a proposed export-oriented refinery in the

president's home district of Hambantota (ref A and C). The UAE-based ETA Aston Group and the Dubai-based Al Ghurair Group had proposed a joint venture to invest $1.2 billion to build 100,000 barrel per day refinery that would compete with Singapore's refineries. Sri Lanka's Board of Investment gave initial approval to the project, but it has since stalled. Prior to this, there had been reports of a possible Chinese refinery investment in Hambantota. There are also periodic reports of a possible private Indian refinery investment in Trincomalee.

COMMENT: AFTER IRAN FLAKES AND CPC STRIKES OUT,
GLOBAL ENERGY BID COULD ADVANCE
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¶9. (SBU) Aside from the complicating and delaying effect of the Iran offer, and of the similar offers that preceded it, the Ceylon Petroleum Corp's effort to do the expansion on its own also appears to have made little progress in nine months of trying. The CPC has not found a serious private financing source, probably due to the fact that its overall balance sheet is weak and its loan service prospects are dimmed by its state ownership, which often dictates that it sell fuel below cost. (For example, during the first nine months of 2007, the CPC made about $35 million in profit on refining after the government allowed it to sell gasoline at market rates. However, as oil prices continued to rise, the government decided in October to defer further fuel price increases until early 2008. This left the CPC selling gas and diesel at a loss. The CPC chairman told Econoff that he simply hoped to finish up the year by

breaking even.)

¶10. (SBU) Meanwhile, the Finance Ministry seems determined to avoid spending Sri Lankan money on a refinery expansion. The ministry fails to see that the best solution would be a BOOT project like Global Energy's, rather than one financed by a donor with no track record and possible conflicts of interest. Post will continue to advance this point in close coordination with Global Energy.
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